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## Agenda Item 4

April 11, 2011

### TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Judges' II (JRS II) and Legislators' (LRS) Retirement Systems Annual Update and Strategic Asset Allocation
- II. PROGRAM:** Affiliate Investment Programs Division
- III. RECOMMENDATION:** Staff recommends the Investment Committee adopt an asset allocation policy portfolio from the recommendations presented for JRS II (Attachment 1, page 6) and for LRS (Attachment 1, page 11).

Wilshire's opinion letter is included as Attachment 2.

### IV. ANALYSIS:

#### **Background**

CalPERS is responsible for the administration of the Judges' Retirement System II (JRS II) and the Legislators' Retirement System (LRS) and for setting the member and employer contribution rates for each plan. The plans are invested according to an asset allocation strategy approved by the CalPERS Investment Committee and managed by CalPERS Investment staff.

The JRS II was established in 1994 and provides retirement and death benefits for Supreme and Appellate Court Justices and Superior Court Judges, first appointed or elected on or after November 9, 1994. This system provides for a combination of two basic types of retirement benefits: a defined benefit plan and a monetary credit plan. The monetary credit plan allows for either a single lump sum payment or an annuity at retirement based on the accumulated contributions of the member and the employer.

The LRS was established in 1947 and provides defined retirement and death benefits to members of the Legislature serving prior to November 7, 1990, and elected Constitutional and Legislative Statutory Officers. The Political Reform Act of 1990 (Proposition 140) requires that Legislators (Senators and Members of the Assembly) first elected on or after November 7, 1990 participate in the federal Social Security system and no other retirement system.

## **Judges' Retirement System II**

As of June 30, 2010, JRS II had 1,197 active members and 19 retired members, and survivor or beneficiary recipients. Both employers and members contribute to the plan monthly. In fiscal year 2010, total contributions into the plan were \$58.8 million, while total benefit payments out of the plan were \$1.4 million. The current projected funded status of the plan is 77% and the duration, or average projected years of discounted benefit payments is 16 years.

## **Performance**

The JRS II Fund has performed in line with expectations since inception. Over the last 3 years, the JRS II Fund generated a total return of 3.54%, essentially matching its benchmark.

The JRS II Fund performance is shown below in Table 1.

**Table 1: Fund Performance**

Periods Ended 2/28/11 (gross)	Mkt Value \$(000)	Qtr	1 Year	3 Year	Annualized 5 Year	10 Year	ITD	Inception
JRS II Fund	535,701	8.20	18.18	3.54	4.51	5.04	6.53	12/1/1996
JRS II Policy Index		7.69	17.92	3.55	4.56	5.15	6.55	
<b>Excess Return</b>		<b>0.51</b>	<b>0.26</b>	<b>-0.01</b>	<b>-0.05</b>	<b>-0.11</b>	<b>-0.02</b>	

Source: State Street Bank. Note: The JRS II Policy Index is a composite benchmark composed of the underlying asset class benchmarks weighted by asset class policy targets.

## **Asset Allocation History**

The asset allocation policy history for the JRS II System is provided below. In August 2004 both the fixed income and domestic equity allocations were decreased to allow for a 10% allocation to Real Estate Investment Trusts (REITs) to provide greater diversification for the fund.

**Table 2: Asset Allocation Policy Timeline**

**CalPERS Judges' Retirement System II  
Asset Allocation Policy History**

	<u><b>12/16/96</b></u>	<u><b>8/16/04</b></u>
Domestic Equity	40%	34%
International Equity	<u>20%</u>	<u>20%</u>
<b>Total Equity</b>	<b>60%</b>	<b>54%</b>
Domestic Fixed Income	40%	36%
Cash Equivalents	<u>0%</u>	<u>0%</u>
<b>Total Fixed Income</b>	<b>40%</b>	<b>36%</b>
<b>Real Estate Investment Trusts (REITs)</b>		10%
<b>TOTALS:</b>	<u><b>100%</b></u>	<u><b>100%</b></u>

**Legislators' Retirement System**

As of June 30, 2010, LRS had 13 active and 23 inactive members, and 255 retired members, and survivor or beneficiary recipients. Due to its extremely well-funded status over the years, there have been no required employer contributions since 1998 and no employee contributions since 2000. The estimated June 30, 2010 funded status of the plan was 107% and the duration, or average projected years of discounted benefit payments is 10 years.

**Performance**

Since inception, the LRS Fund has slightly underperformed its policy index by 0.07% as of February 28, 2011. Over the last 3 years, the LRS Fund generated a total return of 5.30%, outperforming its benchmark by 0.60%.

The LRS Fund performance is shown below in Table 3.

**Table 3: Fund Performance**

Periods Ended 2/28/11 (gross)	Mkt Value \$(000)	Qtr	1 Year	3 Year	Annualized			ITD	Inception
					5 Year	10 Year			
LRS Fund	123,864	5.13	14.35	5.30	5.70	5.57	9.02		7/1/1988
LRS Policy Index		4.40	13.64	4.70	5.36	5.78	9.09		
<b>Excess Return</b>		<b>0.73</b>	<b>0.71</b>	<b>0.60</b>	<b>0.34</b>	<b>-0.21</b>	<b>-0.07</b>		

Source: State Street Bank. Note: The LRS Policy Index is a composite benchmark composed of the underlying asset class benchmarks weighted by asset class policy targets.

### Asset Allocation History

The asset allocation policy history for the LRS is provided below. The fixed income allocation was increased and the domestic equity allocation was decreased in June 2000 to reduce risk and an allocation to Treasury Inflation Protected Securities (TIPS) was added in March 2004 to provide inflation protection for the plan.

**Table 4: Asset Allocation Policy History**

#### **CalPERS Legislators' Retirement System Asset Allocation Policy History**

	<u>Prior</u>	<u>6/19/00</u>	<u>3/15/04</u>
Domestic Equity	40%	30%	30%
International Equity	<u>10%</u>	<u>10%</u>	<u>10%</u>
<b>Total Equity</b>	<b>50%</b>	<b>40%</b>	<b>40%</b>
Domestic Fixed Income	48%	58%	50%
Treasury Inflation Protected Securities (TIPS)			10%
Cash Equivalents	<u>2%</u>	<u>2%</u>	<u>0%</u>
<b>Total Fixed Income</b>	<b>50%</b>	<b>60%</b>	<b>60%</b>
<b>TOTALS:</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

### Asset Allocation Discussion

The recommended policy portfolios for JRS II and LRS, listed on slides 6 and 11 of Attachment 1, are different in recognition of the distinct characteristics of each plan. For JRS II, the vast majority of its members are active, cash flow is substantially positive, and the funded ratio is much lower, suggesting a more aggressive portfolio if the downside risk is acceptable. For LRS, a conservative

portfolio is recommended because the plan is approximately fully funded, its cash flows are substantially negative, and its population consists predominantly of retirees.

The recommended policy portfolios are based on capital market assumptions from the Board's November 8 and 9, 2010 asset liability management (ALM) workshop. Staff's analysis, assumptions and the recommended portfolios are provided in Attachment 1 for JRS II and LRS. Staff will present this analysis at the April Investment Committee meeting.

## **V. STRATEGIC PLAN:**

These initiatives address two CalPERS Strategic Plan Goals.

- Goal VIII to manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions; and
- Goal IX to achieve long-term, sustainable, risk adjusted returns.

## **VI. RESULTS/COSTS:**

Adoption of the recommended policy portfolios for JRS II and LRS will result in some transaction costs, though these costs are expected to be small relative to the benefits.

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